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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

No. 1025

HENRY A. BERLINER, JOSEPHINE M. BERLINER, ROBERT B. FRANK as Trustee for CORA ANNE B. CUNNINGHAM, JOSEPHINE L. B. VARGAS and HENRY A. BERLINER JR.,

Petitioners,

v.

DISTRICT OF COLUMBIA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

No.

HENRY A. BERLINER, JOSEPHINE M. BERLINER, ROBERT B. FRANK as Trustee for CORA ANNE B. CUNNINGHAM, JOSEPHINE L. B. VARGAS and HENRY A. BERLINER JR.,

Petitioners,

v.

DISTRICT OF COLUMBIA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioners pray that a writ of certiorari issue to reverse the judgments of the United States Court of Appeals for the District of Columbia Circuit entered in the above-entitled consolidated causes No. 14024 through 14028, inclusive, on May 1, 1958.

CITATIONS TO OPINIONS BELOW

The opinion of the District of Columbia Tax Court in the above-entitled consolidated causes is unreported

and appears at J. A. 21-44. The opinion of the Circuit Court of Appeals is as yet unreported and appears attached hereto as "Appendix A."

JURISDICTION

The judgment of the Court of Appeals in the above-entitled consolidated causes was entered on May 1, 1958 (R. 72). The jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1), 62 Stat. 928 and D. C. Code, § 47-2404(a) Supp. VI (1957), Act of July 10, 1952, 66 Stat. 544, ch. 649 § 3(b).

QUESTION PRESENTED

Whether the due process clause of the Fifth Amendment of the Constitution protects the citizens of the District of Columbia (as it does the citizens of the several States) from imposition of income taxes (a) under presumptions contrary to fact, or (b) without regard to the gain or loss realized by a taxpayer, or (c) under arbitrary classifications among taxpayers, and if so, whether sums in excess of par or stated value of stock received by a stockholder upon the liquidation or dissolution of a corporation, should be considered as received from a disposition of "capital assets" or as from "dividends" under the District of Columbia Revenue Laws.

STATUTES INVOLVED

The statutory provisions upon which the District of Columbia income tax was levied, appear in Title 47, §§ 1557, 1557a, 1551c, and 1595 of the District of Columbia Code (1951 Ed.), and the applicable parts thereof are printed and attached hereto as "Appendix B."

STATEMENT

Petitioners Henry A. Berliner and Josephine M. Berliner are husband and wife. Cora A. B. Cunningham, Josephine L. B. Vargas and Henry A. Berliner, Jr. are, respectively, the married daughters and unmarried son of Mr. and Mrs. Berliner. (J. A. 5.). Robert B. Frank is a successor Trustee for the aforementioned children of Mr. and Mrs. Berliner and is entitled to the same relief, if any, as his predecessor Trustee (J. A. 6, 7). All the foregoing persons are residents of the District of Columbia, except Mrs. Vargas who is a resident of Reno, Nevada (J. A. 21).

On January 2, 1937, Mr. and Mrs. Berliner, and for the purposes of this petition, Robert B. Frank, Trustee for the three children of Mr. and Mrs. Berliner, acquired the following number of shares of common stock of the Engineering and Research Corporation (hereinafter termed "ERCO"), a Maryland corporation, full paid and non-assessable, at a cost of One Hundred Dollars ($100) per share, and each of said parties continuously from that date thenceforward owned said shares of stock of said corporation until December 9, 1954, as follows (J. A. 5, 6, 10):

SCHEDULE 1

	No. of Shares
Henry A. Berliner	50
Josephine M. Berliner	10
Robert B. Frank, Trustee for Cora A. B. Cunningham	10
Robert B. Frank, Trustee for Josephine L. B. Vargas	10
Robert B. Frank, Trustee for Henry A. Berliner, Jr.	10

On November 15, 1954, ERCO, which carried on its business activities in the State of Maryland, sold its business to ACF Industries, Incorporated, a New Jersey corporation (hereinafter called "ACF"). Following said date, ERCO transacted and conducted no business whatsoever, and carried on no activities of any kind, save and except incident to its liquidation and dissolution which it commenced on November 26, 1954, and concluded on December 27, 1954 (J. A. 7, 25). On December 9 and 21, 1954, ERCO duly distributed its assets to its stockholders and each received his pro rata share of the assets of ERCO, consisting substantially of cash, as follows (J. A. 8, 9, 24):

SCHEDULE 2

	Total Received
Henry A. Berliner	$1,284,582.50
Josephine M. Berliner	256,916.50
Robert B. Frank, Trustee for Cora A. B. Cunningham	256,916.50
Robert B. Frank, Trustee for Josephine L. B. Vargas	256,916.50
Robert B. Frank, Trustee for Henry A. Berliner, Jr.	256,916.50
	$2,312,248.50

Henry A. Berliner had paid Five Thousand Dollars ($5,000) for his stock and each of the other four stockholders had paid One Thousand Dollars ($1,000) (J. A. 5, 6, 10). The foregoing distribution consisted of $9,000.00 capital and the remainder was paid out of the surplus of ERCO theretofore acquired by ERCO from (1) its operations commencing January 2, 1937, and terminating December 9, 1954, and (2) the proceeds of sale of its business to ACF under the contract of sale of November 8, 1954 (J. A. 19, 24).

When ERCO distributed its assets to its stockholders, the Assessor for the District of Columbia included in the income of each of them the pro rata share of each of them in the surplus of ERCO reflected on its books (J. A. 19, 24) without distinction as to the surplus which had been earned by ERCO from its operations to the date of sale, $613,628.54, and the surplus arising from the sale of the business. The surplus arising from the sale of the business represented increment in value of the assets over the years prior to the sale (J. A. 26, 30).

Income taxes were assessed against petitioners as follows (J. A. 27):

	Income Tax	Interest
Henry A. Berliner	$51,883.30	3,881.23
Josephine M. Berliner	9,933.11	753.23
Robert B. Frank, Trustee for Cora A. B. Cunningham	10,082.66	764.57
Robert B. Frank, Trustee for Josephine L. B. Vargas	10,082.66	764.57
Robert B. Frank, Trustee for Henry A. Berliner, Jr.	10,082.66	764.57

The foregoing income taxes and interest were paid by petitioners and petition for refund was duly filed by them in the District of Columbia Tax Court and denied. Petitioners' appeals followed to the United States Court of Appeals for the District of Columbia Circuit where the decision of the Tax Court was affirmed.

The assessment of the tax by the Assessor for the District of Columbia proceeded upon the theory that the District of Columbia Revenue Acts, § 47-1557a(a), defined gross income as including "dividends" and in turn, § 47-1551c(m) defined the word "dividend" to mean:

> ". . . any distribution made by a corporation . . . out of its earnings, profits or surplus . . . and whether distributed prior to, during, upon or after liquidation or dissolution of the corporation: *Provided, however,* that in the case of any dividend which is distributed other than in cash or stock in the same class in the corporation *and not exempted from tax under this article,* the basis of the tax to the recipient thereof shall be the market value of such property at the time of such distribution . . ." (Italics added.)

Petitioners contended that the definition of gross income, § 47-1557a(a), excluded "income derived from . . . capital assets" which were defined as, § 47-1551c(l):

> ". . . any property . . . held by the taxpayer for more than two years."

Petitioners contended below that sums received by them as stockholders of ERCO in dissolution were not "dividends" within the customary and usual meaning of the term but were received as the result of a sale or exchange of stock in dissolution of their corporation. They further contended that if the definition of dividends contained in the District of Columbia Revenue Acts be presumed to create a conclusive presumption that sums obtained were dividends, when in truth and in fact those sums were not dividends, then the District of Columbia definition of dividends is in violation of the Fifth Amendment to the Constitution.

Petitioners further contended that the definition of dividends in the District of Columbia Revenue Acts purports to measure a tax on stockholders of a corporation, after the corporation liquidates and dissolves, not by the gain or loss realized by the stockholder but

by the amount of profit accumulated by the corporation. Thus, argued petitioners, the tax upon stockholders of a corporation is not measured by the income of the stockholders but by the income of the corporation, a third party. To attempt to levy an income tax upon the stockholders of a corporation, on the basis of the earnings of the corporation, rather than on the basis of the gain or loss realized by the stockholders, is to attempt to tax individuals because of the earnings of someone else, namely, the corporation, a taxing system heretofore held to be unconstitutional, in violation of the Fourteenth Amendment, the standards of which in a similar case have been held to be identical with the standards of the Fifth Amendment.

Furthermore, petitioners contended that when stockholders of a corporation, on liquidation and dissolution, receive their pro rata distribution of assets of the corporation, they transfer title to their shares of stock in exactly the same way that stockholders convey title to stock when they dispose of it by sale or exchange. The District of Columbia Revenue Acts exclude from gross income the proceeds of sale or exchange of stock which has been owned for more than two years. To exclude from tax, proceeds of sale or exchange, but to levy a tax upon receipt of proceeds of liquidation or dissolution of a corporation, when the incidents of the transaction are the same, and no possible reason exists for a distinction between the two transactions, petitioners claimed would constitute an arbitrary and unreasonable classification among taxpayers in violation of the Fifth Amendment.

REASONS FOR GRANTING THE WRIT

I

The Court of Appeals Extended the Holding of Neild v. District of Columbia to State the Foregoing Considerations Probably Not Relevant for Purposes of the Fifth Amendment

Petitioners respectfully state that the due process clause of the Fifth Amendment affords protection to the citizens of the District of Columbia from the enforcement of Revenue laws which impose (a) conclusive presumptions contrary to fact; (b) taxes without regard to the gain or loss realized by the taxpayer; and (c) arbitrary and unreasonable classifications among taxpayers. The Fifth Amendment protects citizens of the several States and citizens of the District of Columbia should have the same protection. For the Court of Appeals to hold petitioners' contentions "probably not relevant for purposes of the Fifth Amendment" and to base that statement upon the decision in *Neild* v. *District of Columbia*, 71 App. D. C. 306, 110 F. 2d 246 (1940), is to graft upon the legal system of the District of Columbia exceptions from the benefit of the Fifth Amendment which should not be permitted to stand unchallenged. The question is of the gravest public importance to citizens of the District of Columbia and presents an important question of Federal law which should be settled by this Court. In *Steward Machine Co.* v. *Davis*, 301 U. S. 548, 585 (1937), this Court stated that it might assume that discrimination, in a Federal taxing statute "if gross enough, is equivalent to confiscation and subject under the Fifth Amendment to challenge and annulment." This Court has heretofore stricken down distinctions based on arbitrary classifications. *Martin* v. *District of Columbia*, 205 U. S. 135 (1907); *Air-way Electric Appliance Corp.* v. *Day*, 266 U. S. 71 (1924);

Quaker City Cab Co. v. *Pennsylvania*, 277 U. S. 389 (1928); *Nichols* v. *Coolidge*, 274 U. S. 531 (1927); *Southern Railway Co.* v. *Greene*, 216 U. S. 400 (1910).

Actually, *Neild* v. *District of Columbia*, *supra*, expressly stated, 71 App. D. C. 306, 317:

> "In a sense it may be said that every citizen is entitled to the equal protection of the laws as they may be adopted and administered by the Federal Government throughout the land,"

citing *Truax* v. *Corrigan*, 257 U. S. 312, 332 (1921), in a footnote where it is said:

> "It [due process], of course, tends to secure equality of law in the sense that it makes a required *minimum of protection* for everyone's right of life, liberty and property, which the Congress or the legislature may not withhold. Our whole system of law is predicated on the general fundamental principle of equality of application of the law." (Italics in original.)

Thus, to say that citizens of the District of Columbia are probably not to be permitted to raise questions of the protection of the Fifth Amendment against arbitrary and unreasonable classification among taxpayers, or imposition of conclusive presumptions contrary to fact, or taxes measured by gains or losses realized by persons other than the taxpayer, is to permit an extension of the doctrine of *Neild* v. *District of Columbia*, *supra*, far beyond its reasonable or lawful implications.

Moreover, this Court has recognized that the due process clause of the Fifth Amendment covers much of the same ground as the equal protection clause of the Fourteenth. *Detroit Bank* v. *U. S.*, 317 U. S. 329

(1943); *Currin* v. *Wallace*, 306 U. S. 1, 13-14 (1939); *Steward Machine Co.* v. *Davis, supra.* In striking down under the Fifth Amendment the segregated school system of the District of Columbia which it had on the same day found to violate the equal protection clause of the Fourteenth Amendment, *Brown* v. *Board of Education*, 347 U. S. 483 (1954), the Court observed that:

> "Classifications based solely on race must be scrutinized with particular care since they are contrary to our traditions and hence constitutionally suspect." *Bolling* v. *Sharpe*, 347 U. S. 497, 499 (1954).

Any kind of artificial classification must therefore fall into the same category. To paraphrase the language of the Court in *Bolling* v. *Sharpe, supra*, it would be unthinkable that a Constitution which would forbid discrimination in a taxation by the States would sanction such discrimination in the District of Columbia.

Accordingly, it is forcefully maintained that, contrary to the language of the Court of Appeals, citizens of the District of Columbia are not excluded from the protection of the Fifth Amendment afforded the citizens of the several States, against arbitrary and unreasonable classifications among taxpayers and this Court should so hold.

II

It Is An Arbitrary and Capricious Exercise of the Taxing Power in Violation of the Fifth Amendment to Tax Petitioners for Receipt of a Dividend When Petitioners in Truth Exchanged Their Stock With Their Corporation Upon Liquidation

Under the Revenue Acts of the District of Columbia, § 47-1557a(b)(11), there is excluded from gross income "gains from the sale or exchange of any capital

asset" which in turn is defined, § 47-1551c(l) as "any property . . . held by the taxpayer for more than two years . . ." Thus, citizens of the District of Columbia may exclude from gross income proceeds of sale or exchange of stock held by them for more than two years. Yet, because of the definition of dividend contained in § 47-1551c(m) as construed by the Assessor, and supported by the Court of Appeals, holders of shares of stock who exchange their stock with their corporation when the latter liquidates, are taxed. Receipt of proceeds of liquidation from a corporation does not constitute receipt of a dividend. Compare *Lynch* v. *Turrish*, 247 U. S. 221 (1918) with *Lynch* v. *Hornby*, 247 U. S. 339 (1918). So to hold construes the statute to create an arbitrary conclusive presumption, contrary to fact. Arbitrary conclusive presumptions, contrary to fact, have been held to violate the tests of both the Fifth and Fourteenth Amendments to the Constitution. *Heiner* v. *Donnan*, 285 U. S. 312 (1932).

III

When the Revenue Laws of the District of Columbia, Are Construed to Levy a Tax Upon Petitioners, the Measure of the Tax Is the Earnings or Surplus of the Corporation in Liquidation or Dissolution and Not the Income or Gain Derived by Petitioners; Hence the Asserted Tax Purports to Measure the Tax on Petitioners' Income by Referring to the Income of the Corporation, a System in Violation of the Fifth Amendment to the Constitution of the United States

It is to be noted that ". . . any attempt to measure the tax on one person's property or income by reference to the property or income of another . . ." is unconstitutional under the standards of the Fourteenth Amendment to the Constitution of the United States. *Hooper* v. *Tax Commission*, 284 U. S. 206 (1931). As has been shown, the standards set up by the Fifth

Amendment (applicable to Federal action) and the Fourteenth Amendment (applicable to state action) are for this purpose identical. *Heiner* v. *Donnan, supra.*

In *Hoeper* v. *Tax Commission, supra*, an income tax was laid upon the income of the husband under a state statute which required to be included in the gross income of the husband, all earnings of the wife. Since the husband had not in fact realized income from his wife's earnings, the Court held the state tax to be unconstitutional. Thus, Congress, acting as a state legislature in exercising the power to tax residents of the District of Columbia, must conform to the same standard held by the Court to be required in *Hoeper, supra.*

Under the definition of the word "dividend" contained in the District of Columbia Revenue Acts, no recognition is accorded to the actual basis of the stock in the hands of the shareholder receiving distribution on liquidation. In cases (1) where loss is actually sustained by the shareholder, the Assessor would construe the statutory definition of dividend in a manner resulting in tax upon the shareholder, and (2) where gain is realized, the Assessor would assess no tax.

For example, *a loss which would be taxed as a dividend* A pays B $100,000 for one-half the stock of X Corporation, which owns net assets of $200,000 represented by capital of $100,000 and earned surplus of $100,000. *After several loss years*, X Corporation has net assets of only $150,000 and liquidates. A receives one-half of the then existing net assets, or $75,000, represented by $50,000 capital and $25,000 earned surplus, his pro rata portion of each. A has actually sustained a loss of $25,000; yet according to the Assessor,

would be taxable upon $25,000 (his pro rata share of earned surplus) as a dividend.

For an additional example, *a gain which would not be taxed as a dividend* A pays B $100,000 for one-half the stock of X Corporation, which owns net assets of $200,000, represented by capital of $400,000 less incurred deficits in operation of $200,000. *After a windfall profit*, X Corporation has earned $200,000 in operations so that its initial capital of $400,000 is restored to it. X Corporation then liquidates. A receives one-half of the then existing net assets, or $200,000, consisting of all capital, his pro rata portion of then existing net assets. A has actually realized a gain of $100,000; yet according to the Assessor, would not be taxable at all because the corporation had no accumulated earnings at time of liquidation.

Obviously the District of Columbia taxing statutes should not be construed to levy a tax (1) when no gains are realized or (2) when gains are realized from the disposition of capital assets, as the same are defined under local law (assets held for more than two years).

It may therefore be seen that the taxing system sustained by the taxing authorities below is so arbitrary and capricious and leads to such absurd results as to be in violation of the due process clause of the Fifth Amendment of the Constitution, from the protection of which the citizens of the District of Columbia, as distinguished from the citizens of the several states, are not to be excluded.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully Submitted,

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APPENDICES A AND B FOLLOW

APPENDIX

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 14,024

HENRY A. BERLINER, PETITIONER,

v.

DISTRICT OF COLUMBIA, RESPONDENT.

No. 14,025

JOSEPHINE M. BERLINER, PETITIONER,

v.

DISTRICT OF COLUMBIA, RESPONDENT.

No. 14,026

ROBERT B. FRANK, Trustee for CORA A. BERLINER CUNNINGHAM, PETITIONER,

v.

DISTRICT OF COLUMBIA, RESPONDENT.

No. 14,027

ROBERT B. FRANK, Trustee for JOSEPHINE L. BERLINER VARGAS, PETITIONER,

v.

DISTRICT OF COLUMBIA, RESPONDENT.

No. 14,028

ROBERT B. FRANK, Trustee for HENRY A. BERLINER, JR., PETITIONER,

v.

DISTRICT OF COLUMBIA, RESPONDENT.

On Petitions for Review of Decisions of the District of Columbia Tax Court

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Decided May 1, 1958

Mr. Bernard I. Nordlinger, with whom *Messrs. Milton W. King, Wallace Luchs, Jr., Robert B. Frank* and *Charles Kershenbaum* were on the brief, for petitioners. *Mr. W. David Huddle* also entered an appearance for petitioners.

Mr. Henry E. Wixon, Assistant Corporation Counsel for the District of Columbia, with whom *Messrs. Chester H. Gray*, Corporation Counsel, *Milton D. Korman*, Principal Assistant Corporation Counsel, and *Douglas H. Moore, Jr.*, Assistant Corporation Counsel, were on the brief, for respondent.

Before Fahy, Washington and Danaher, Circuit Judges.

Washington, *Circuit Judge*: These cases arise under the income tax laws of the District of Columbia. They present the question whether amounts distributed in complete liquidation of a corporation, to the extent that those amounts exceed the cost of the stock and represent corporate earnings, are properly includible in the stockholders' gross income as a dividend under Section 47-1551c(m) of the District of Columbia Code (1951).

In 1937 the petitioners became common stockholders in the Engineering & Research Corporation ("Erco"), each paying to the company the full par value for his or her shares. On November 15, 1954, Erco sold its assets and business to ACF Industries, Inc. ("ACF"), for $3,000,000,[1] realizing a profit of $2,196,371.46 on the sale. On that date Erco had an earned surplus of $613,628.54, a substantial part of which represented earnings in 1954. Following the sale the profit of $2,196,371.46 also was reflected in and became a part of its earned surplus account. In December of 1954 Erco distributed to its common stockholders, pro

[1] This amount was paid in substantial part in cash; the balance was made up by the issuance of 10,000 shares of ACF stock, valued at the stock's market value on the date the contract was closed. In addition to the payment of $3,000,000 for the assets, ACF assumed all of Erco's liabilities, with the exception of certain items specifically excluded by the sale contract.

rata on the stock owned by each, the cash and the ACF stock acquired on the sale of assets, reserving only the amounts required to retire its preferred stock and to pay liabilities not assumed by ACF. It was stipulated that, after excluding the amount of capital included in the distribution,[2] the remainder was paid out of surplus acquired from operating profits up to November 15, 1954, and surplus acquired from the proceeds of the sale of its business to ACF. Erco charged the distribution, after excluding the capital, to earned surplus; it had no paid-in or capital surplus.

In their 1954 income tax returns to the District of Columbia, the petitioning stockholders reported the distribution as a sale or exchange of their stock, a capital asset, resulting in a non-taxable gain. Deficiencies for 1954 were assessed against them, computed by including in taxable income as a dividend under Section 47-1151c(m) of the Code the amount distributed by Erco in complete liquidation, less an amount representing return of capital.[3] The taxpayers paid the taxes so assessed and petitioned for refunds. The District of Columbia Tax Court approved these assessments and denied refunds of the taxes so paid. The present petitions followed.

Section 47-1557a(a) of the Code includes "dividends" within the definition of gross income. Section 47-1551c(m) defines a dividend as—

> "any distribution made by a corporation (domestic or foreign) to its stockholders . . ., out of its earnings, profits, or surplus (other than paid-in surplus), whenever earned by the corporation and whether made in cash or any other property . . . and whether distributed prior to, during, upon, or after liquidation or dissolution of the corporation: . . ."[4]

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[2] *I.e.*, an amount equal to the original capital paid in (the par value of their common stock) by the stockholders.

[3] See footnote 2.

It was stipulated in writing before the Tax Court that the distribution, to the extent taxed, was paid out of surplus, and the evidence showed that Erco had only earned surplus, to which the distribution was charged. The taxpayers made no contention to the contrary here.[5] The

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[4] A proviso to this section reads as follows:

> "*Provided, however*, That in the case of any dividend which is distributed other than in cash or stock in the same class in the corporation and not exempted from tax under this article, the basis of tax to the recipient thereof shall be the market value of such property at the time of such distribution. . . ."

The only part of the dividend here involved which was distributed other than in cash was stock of ACF (not common stock of Erco), which was valued at its market value on the date of distribution as the proviso directs. Taxpayers have pointed out no provision of the income tax law, and we know of none, which exempts a dividend paid in property other than cash or stock of the same class in the paying company, here stock of another company, from tax. Taxpayers do rely on the provisions excluding from gross income the gains on sales or exchanges of capital assets, which will be discussed *infra*. Suffice it to say here that such exclusion provisions do not relate to the exemption from tax of the type of dividend referred to in the proviso.

[5] Such a contention would not be sustainable. There was a gain by the corporation on the sale of its assets. For Federal tax purposes that gain may not have been taxable (*cf.* INT. REV. CODE of 1954, § 337(a) and (b)), and if not recognized as taxable income would not be regarded as increasing Erco's earned surplus by virtue of a specific statutory enactment (INT. REV. CODE of 1954, § 312(f)(1)). But the District statute has no such provision as to the effect on earned surplus. Furthermore, we are not advised as to the status of the gain for District corporate income tax purposes. If the assets sold had been held for more than two years *and* if they were not stock in trade or inventoriable properties or held primarily for sale to customers in the ordinary course of the corporation's business, they would be capital assets as defined in D. C. CODE § 47-1551c(1) and would be excluded from the statutory definition of gross income by D. C. CODE § 47-1557a(b)(11). The corporation's balance sheet on the date of sale should very substantial inventories so that at least a substantial part of the assets sold were not capital assets of the corporation, as defined by stat-

distribution made by Erco, during or upon its liquidation, was thus out of "its earnings, profits, or surplus," earned in part from operations and in part on the sale of its assets in 1954. As such, it falls precisely within the statutory language and the imposition of the tax was required.

The correctness of this view is confirmed by reference to the history of the related Federal taxing provisions.[6] Commencing with the Revenue Act of 1916,[7] c. 463, 39 STAT. 757 (1917), a dividend was defined generally as any distribution out of earnings and profits accumulated after

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ute, and would have been within the broad definition of income contained in D. C. CODE § 47-1557a(a). *Cf.* Commissioner v. Court Holding Co., 324 U. S. 331 (1945); Eisner v. Macomber, 252 U. S. 189, 207 (1920). If some part of the assets sold were within the definition of capital assets of the corporation, which the evidence does not show, and thus were excluded from its income by the statutory definition of gross income, the gain allocable to such part would nevertheless probably be regarded as increasing its earned surplus account in the absence of a statutory provision or regulation to the contrary. *Cf.* Commissioner v. F. J. Young Corp., 103 F. 2d 137 (3d Cir. 1939); Commissioner v. Wheeler, 324 U. S. 542, *rehearing denied*, 325 U. S. 892 (1945); 1 MERTENS, LAW OF FEDERAL INCOME TAXATION, §§ 9.32 and 9.38 (1956). In any event, the stipulation as to the source of the distribution makes such considerations unnecessary here.

[6] See generally 1 MERTENS, LAW OF FEDERAL INCOME TAXATION, §§ 9.63, 9.64, 9.66, 9.87, 9.88, and 9.89 (1956); Darrell, *Corporate Liquidations and the Federal Income Tax*, 89 U. OF PA. L. REV. 907-09 (1941).

[7] Section IIB of the Revenue Act of 1913, c. 16, 38 STAT. 167 (1915), the first act after adoption of the Sixteenth Amendment, included "dividends" in gross income without attempting to define them. Lynch v. Turrish, 247 U. S. 221 (1918), and Lynch v. Hornby, 247 U. S. 339 (1918), were decided under this Act. Read together, they seem to indicate that the Court construed the word "dividends" in that Act as referring to dividends paid in the ordinary course and as not including amounts distributed in complete liquidation of a corporation. But such a construction is not controlling here, where the statutory provisions are different.

February 28, 1913,[8] with certain additions not relevant here, and this definition has continued until the present time.[9] The 1918 Act, the 1924 Act (but not the 1921 Act), and all subsequent acts including the present Code,[10] provide specifically that amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock. Under such specific provisions a liquidating distribution is treated as the proceeds of an "exchange" resulting in gain or loss to the stockholder-recipient, even though the distribution may include corporate earnings and profits, and even though without the specific provision the broad definition of dividends would include distributions in liquidation. See *Hellmich* v. *Hellman*, 276 U.S. 233, 236-237 (1928); *White* v. *United States*, 305 U.S. 281 (1938); *Helvering* v. *Weaver Co.*, 305 U.S. 293 (1938). But in the Revenue Acts of 1916, 1917, and 1921 there was no such specific provision as to the treatment of distributions in complete liquidation. In cases governed by those acts it has been uniformly held that distributions in liquidation, whether partial or complete, fell within the definition of a dividend to the extent that they represented accumulated earnings, and thus were properly taxable as a dividend.[11] The holdings under the 1921 Act

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[8] March 1, 1913, was the effective date of the first revenue act following ratification of the Sixteenth Amendment.

[9] See INT. REV. CODE of 1954, § 316(a).

[10] INT. REV. CODE of 1954, § 331(a)(1).

[11] Under 1916 Act: A. B. Nickey & Sons, 3 B.T.A. 173 (1925).
1917 Act: James Dobson, 1 B.T.A. 1082 (1925); *cf.* Vincent v. McLaughlin, 61 F. 2d 657 (9th Cir. 1932), *petition for certiorari dismissed*, 288 U. S. 618 (1933).
1921 Act: Commissioner v. Sansome, 60 F. 2d 931 (2d Cir.), *cert. denied sub nom.* Sansome v. Burnet, 287 U. S. 667 (1932); Phelps v. Commissioner, 54 F. 2d 289 (7th Cir. 1931), *cert. denied*, 285 U. S. 558 (1932); Leland v.

are especially significant: they construed the general definition of a dividend unequivocally to include distributions of earnings in a liquidation, where the specific provision of the 1918 Act that distributions in liquidation are to be treated as paid in exchange for the stock was omitted from the 1921 Act. See particularly *Commissioner* v. *Sansome*, *supra*, note 11, at 932, and *McCaughn* v. *McCahan*, *supra*, note 11, at 4.

The District statute contains virtually the same definition of a dividend as the Federal statutes have contained since the 1916 Act, with the significant addition that in the District statute Congress included a specific provision that the term "dividend" includes a distribution of earnings "during, upon, or after liquidation."[12] Had Congress intended that such a distribution be treated as an exchange, we think it would have omitted the reference to liquidating distributions in the definition of a dividend and would have included a provision similar to that which has appeared in the Federal statutes uninterruptedly since 1924. We must therefore reject the taxpayers' contention that

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Commissioner, 50 F. 2d 523 (1st Cir.), *cert. denied*, 284 U. S. 656 (1931); McCaughn v. McCahan, 39 F. 2d 3 (3d Cir. 1930); Hamilton Woolen Co., 21 B.T.A. 334 (1930); Frank D. Darrow, 8 B.T.A. 276 (1927); *cf.* Holmquist v. Blair, 35 F. 2d 10 (8th Cir. 1929).

[12] See Section 47-1551e(m), above quoted. The provision with which we are here concerned was enacted in 1947. Previously, the 1939 tax act defined the word "dividend" as "any distribution made by a corporation out of its earnings and profits . . .", and provided:

> "It includes such portion of the assets of a corporation distributed at the time of dissolution as are in effect a distribution of earnings." See D. C. Code, § 47-1543(16) (Supp. V, 1956).

The change in the 1947 Act seems to us to have been adopted to eliminate the necessity of a finding that a distribution is "in effect" a distribution of earnings, when some of the assets distributed represent earned surplus.

the transaction should be held to be an exchange, the gain from which is excluded from gross income by Section 47-1557a(b) (11).[13]

The petitioners recognize that the statutory definition of a dividend is broad enough to include the liquidating distributions to them, after capital is excluded. But, petitioners argue, the statutory language should not be applied literally here to tax as a dividend the part of the distribution which represents earnings, because to do so would lead to results not intended by Congress. The foregoing discussion demands rejection of this argument. We note, however, that Congress was undoubtedly cognizant that either method of treatment might present some problems in application, *cf.* Magill, *The Income Tax Liability of Dividends in Liquidation*, 23 MICH.L.REV. 565, 566-568 (1925), and that it purposely selected the method of taxing liquidating distributions of earnings as dividends for purposes of the District tax. The wisdom of such a choice is obvious, when the provisions of the District law relating to capital gains (D.C. CODE §§ 47-1551c(1) and 47-1557a(b) (11)) are considered. If distributions like the present were treated as sales or exchanges of stock, as taxpayers argue they should be, some stockholders (those who had owned their stock for more than two years) would escape tax altogether on receipt of the corporate earnings whereas other stockholders would be taxed in full on receipt of exactly the same distribution of earnings merely because they had held their stock for only two years or less. Such a difference in treatment for the same distribution would hardly be justified by logic—and, as we read the statutes, Congress has not authorized it. The argument that the dis-

[13] It is here relevant to note that if these distributions are considered to be "gains from the sale or exchange of any capital asset," as defined in D. C. CODE §§ 47-1557a(b)(11) and 47-1551c(1), they would escape District tax entirely. This is in contrast to the Federal statutes which do not exempt capital gains but tax them in a special way. See INT. REV. CODE of 1954, § 1201 *et seq.*

tributions "grew out of" the ownership of stock would be equally applicable to any distribution of earnings, including dividends in the ordinary course paid by corporations not in liquidation, and is hardly persuasive as a reason for holding these distributions not within the literal statutory language.

Finally, the taxpayers contend that the Fifth Amendment prohibits taxation as dividends of amounts distributed in liquidation to the extent that they represent corporate earnings. Their argument is two-fold: that to do so taxes the stockholder on the earnings of another entity, the corporation, and that it arbitrarily and capriciously provides a different treatment from that afforded stockholders who sell their stock to third persons. The first point, if accepted, would prohibit the taxation of any distribution of corporate earnings to a stockholder as a dividend. But, of course, the point cannot be accepted. *Cf. United States* v. *Phellis*, 257 U.S. 156, 169 (1921). In respect of the taxpayers here the argument overlooks the fact that the distributions not only returned to them their capital investments in full but also a substantial additional amount as a gain or profit. The question is whether the Fifth Amendment permits Congress to tax this profit as dividend income, when it also represented a distribution of corporate earnings. The courts have frequently recognized that a distribution of earnings in liquidation may rationally be treated as a dividend as well as an exchange.[11] It was constitutionally open to Congress to elect to tax the profit as a dividend for purposes of the District tax, just as it was constitutional for it to do so for purposes of the 1921 Federal Act. *Commissioner* v. *Sansome*, *supra* note 11, at 932. *Cf. Neild* v. *District of Columbia*, 71 App. D.C. 306, 110 F.2d 246 (1940).

To be sure, this method of taxation provides a different treatment from that accorded to stockholders who sell

[11] *See, e. g.*, cases cited in fn. 11; Hellmich v. Hellman, 276 U. S. 233 (1928); Magill, *supra*, 23 Mich. L. Rev. at 566-568.

their stock to third persons. But such a sale does not involve a distribution by the corporation of its earnings and capital in liquidation, and has no element of a dividend, unlike the distributions here.[15] It thus cannot be thought to be unreasonable or arbitrary to treat sales of stock to third persons as sales and to treat distributions in liquidation as dividends to the extent that earnings are included—although such considerations are probably not relevant for purposes of the Fifth Amendment. *Neild v. District of Columbia*, *supra* at 318-320, 110 F.2d at 258-260.

Affirmed.

DANAHER, *Circuit Judge*, dissenting: Deficiencies in income tax were asserted by the Assessor against the petitioners as individual resident taxpayers who had received cash and securities upon the liquidation of Engineering and Research Corporation, a Maryland Corporation (ERCO), in which they had been stockholders.

An income tax may be levied upon the "net income" of a taxpayer resident in the District, to be sure, but the words "net income" are defined to mean "the gross income of a taxpayer less the deductions allowed by this article." D. C. CODE § 47-1557 (1951). In turn, the words "gross income" by definition include, in part, income derived from "dealings in property, whether real or personal, *other than capital assets*," D. C. CODE § 47-1557(a) (1951) (Emphasis supplied.) Certainly the shares in the hands of the stockholders constituted "capital assets,"[1]

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[15] We do not think that the same could necessarily be said of a sale of stock back to the issuing corporation itself. It may be that in some circumstances such a sale would amount to a partial (or even a complete) liquidation. We make no comment as to the possible tax consequences of a sale by the stockholders of all ERCO stock to another corporation, such as ACF.

[1] Garrett v. District of Columbia, 81 U. S. App. D. C. 374, 159 F. 2d 457 (D. C. Cir. 1946), *cert. denied*, 330 U. S. 835 (1947).

whatever the value of those shares might be, since they were "held by the taxpayer for more than two years." D. C. CODE § 47-1551(c)(1) (1951). The Code further provides that "gains from the sale or exchange of any capital asset as defined in this article" are capital gains, D. C. CODE § 47-1557(b)(11) 1951).[2]

The Tax Court concluded that the cash and securities distributed by ERCO constituted "dividends" within the meaning of D. C. CODE § 47-1551c(m) (1951), which in pertinent part reads:

> "(m) The word 'dividend' means any distribution made by a corporation (domestic or foreign) to its stockholders or members, out of its earnings, profits, or surplus (other than paid-in surplus), *whenever earned by the corporation* and whether made in cash or any other property . . . and whether distributed prior to, during, upon, or after liquidation or dissolution of the corporation: *Provided, however*, That in the case of any dividend which is distributed other than in cash or stock in the same class in the corporation and *not exempted from tax under this article*, the basis of tax to the recipient thereof shall be the market value of such property at the time of such distribution . . ." (Emphasis supplied.)

It seems to me that the key to the foregoing section, as here applied, must be found in the language "whenever earned by the corporation." I think the District Code, as amended in 1947, had been simply drawn, and intentionally so, in contradistinction from the far more complicated Internal Revenue Code. The draftsmen sought to reach a liquidation, whether it be partial or complete. They sought to avoid the many complications such as have arisen under the federal law.

The draftsmen knew that distributions "in kind" have given rise to myriad problems under the federal law.

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[2] The general definitions in the Code "are the generally accepted ones for the words defined." S. REP. No. 280 to accompany H.R. 3737, Vol. 2 Senate Reports (1947) 80th Cong. 1st Sess.

See, *e.g.*, *Commissioner of Internal Rev.* v. *Hirshon Trust*, 213 F.2d 523 (2 Cir. 1954), *cert. denied*, 348 U.S. 861 (1954). Thus, for the purposes of the tax law of the District of Columbia, as to distributions "in kind," they added the proviso, above noted, defining the taxpayer's "basis" but only as to property so distributed which is "not exempted from tax." Surely Congress did not stultify itself by this deliberately selected language in this very section.

To recapitulate, Congress sought simply to class as dividends to stockholders the distribution of *earnings*, whenever paid out, and whether in complete or partial liquidation or dissolution or otherwise. Reverting to the definition of "dividend," we see that its reach applies to a distribution by a corporation of its property, whether it be cash or otherwise, if that distribution is made "out of its earnings, profits, or surplus (other than paid-in surplus), whenever earned by the corporation."[3]

I see no complexity inherent in the sweep of this language. The Tax Court said in its opinion that "There can be no doubt that all of such items, with the exception of the $190,000 capital item, were surplus." Thus the Tax Court treated the entire sum, whether in cash or stock, paid by ACF to ERCO other than paid-in capital, as "surplus," and hence as a dividend or "surplus" income to the stockholders. I believe its error stems from its loose and all-inclusive classification of "surplus," without regard to the type of surplus. Obviously, the Code itself

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[3] Cases are D. C. Code § 47-1543(16) (1940):

> "The word 'dividend' means any distribution made by a corporation out of its *earnings* or *profits* to its stockholders or members whether such distribution be made in cash, or any other property, other than stock of the same class in the corporation. It includes such portion of the assets of a corporation distributed at the time of dissolution as are in effect a *distribution of earnings*." (Emphasis added.)

excludes "paid-in surplus." The term certainly must be taken to exclude unearned surplus, or that represented by appreciation in value. Mr. Justice Brandeis makes the point for me in his opinion in *Edwards* v. *Douglas*, 269 U.S. 204, where at 214 he says:

> "The word 'surplus' is a term commonly employed in corporate finance and accounting to designate an account on corporate books . . . The surplus account represents the net assets of a corporation in excess of all liabilities including its capital stock. This surplus may be 'paid-in surplus,' as where the stock is issued at a price above par. [In our case paid-in surplus is specifically excluded.] It may be 'earned surplus,' as where it was derived wholly from undistributed profits. [In our case, I deem at least $613,628.54 to be "earned surplus," specifically subject to tax.] *Or it may, among other things, represent the increase in valuation of land or other assets made upon a revaluation of the company's fixed property.*" (Emphasis supplied.)[4]

I think the case should be remanded to the Tax Court for a determination of the several elements as separately distinguished by Mr. Justice Brandeis. The words "surplus . . . whenever earned by the corporation" have not here been broken down by evidence of record.

The petitioners had been arguing that no part of the sum paid by ACF was subject to the deficiency tax here asserted. Yet it is perfectly clear that as at December 31, 1953, there was an earned surplus balance of $54,241.64. Again, the corporation between January 1 and November 15, 1954, had net income of $559,386.90. Surely these two items constituted earned surplus, within the

[4] So it was that the parties stipulated that over and above repaid capital, amounts received by the stockholders were "paid and delivered out of *surplus* of [ERCO] and to have been acquired by said corporation from (1) its operations commencing January, 1937, and terminating November 15, 1954, and (2) the *proceeds of sale of its business* to ACF . . ." (Emphasis supplied.)

meaning of the Code, subject to tax, when distributed, as "dividends." Exclusive of capital, the balance was represented by notes and accounts receivable, buildings and other fixed depreciable assets and inventories. There were contracts, work in process and other elements, no doubt. We do not know what they are or the value ascribed to them.

In short, between January, 1937, and November, 1954, the stockholders saw their capital investment grow. No doubt, some earnings were ploughed back. No doubt, some dividends were paid. But the experience of the corporation was one of progress. Its good will was enhanced. Its potential for doing business was expanded. Its management developed a product in demand under Government contract—for all we know, the only such company in the nation in a specialty field.[5] The value of the stock increased accordingly in the hands of its holders, irrespective of what elements contributed to that enhanced value. Thus, it was that invested capital of $190,000 by the time of the ACF transaction represented asset value of $3 million. That amount, in what appears to have been an arm's-length transaction, was what ACF agreed to pay. The stockholders bound themselves expressly by contract not to use the ERCO name, or any similar name, and not for five years to compete with ACF, or even indirectly to become interested in a competitor. ACF saw value in that restriction and ERCO's shareholders were entitled to compensation for it. The contract with ERCO bound ACF to pay $3 million, and ERCO was bound to transfer and did transfer "all of Seller's then existing assets and business, as a going concern, including, without limitation, all rights to the use of the name Engineering and Research Corpora-

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[5] As to the nature of at least some of ERCO's business, see Greene v. McElroy, ——— U. S. App. D. C. ———, ——— F. 2d ——— (D. C. Cir. April 17, 1958).

tion (or any variant thereof) and all patents, applications for patents, trade-marks and licenses."[6]

Then, upon liquidation, ERCO's stockholders surrendered their stock. They exchanged the value back of that stock for $3 million. To the extent that the amounts received thereafter constituted a distribution of surplus *earned* by the corporation, such amounts were dividends under the Code section here applicable. To the extent that such amounts so distributed reflected value, not earned, they also were properly carried on ERCO's books as surplus, possessing, within the meaning of the Code, a capital asset value when related to the stock in the hands of the shareholders. Whatever the exact tax consequences may be depends upon the elements back of that valuation, to be measured in terms of what portion was earned, and on this point no findings have been made. That there was some capital gain to the shareholders seems beyond peradventure.[7]

My colleagues recognize, I see, that if these stockholders had sold their stock to a third person, there would be no income tax because there would be no "dividend," as they construe the term. That is the way the law clearly points, they concede. Presumably the same result would follow had the stock been sold to ACF. Yet they observe that unless their construction of the term "dividend" is here adopted, these stockholders will likewise not be required

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[6] ERCO's contract to sell its business in which the stockholders individually joined, bound ERCO to transfer to ACF net assets of not less than "$586,429, the net worth of Seller as disclosed by its [balance sheet]. The term 'net assets' of Seller as used in this Section shall be deemed to mean the book value of the assets of Seller less its liabilities, including in liabilities all reserves and accruals but *excluding capital* and *surplus accounts*." (Emphasis supplied.)

[7] I do not explore the extent to which these stockholders may be liable to federal taxes because of the distribution, and, of course, we have not considered at all the various aspects of ERCO's liability to the Government.

to pay an income tax on the unearned asset value included in the ERCO "surplus."

I think the result they deplore reflects precisely the purpose of the statute which presents a policy question with which we are not concerned. The 1947 amendment expanded the earlier language[8] so as to reach earnings or profits distributed upon liquidation or dissolution, but otherwise made no change in the principle. If a "dividend" in a corporate liquidation is not a distribution of corporate earnings, but represents only a return of unearned increment, the stockholders have received no more *in value* than they had before surrendering their stock. They have merely exchanged their capital, the shares being evidence of their ownership, for the valuation itself, whether it be distributed in dollars or in property. The Code reaches corporate distributions out of *earnings*, whether distributed currently in a given tax year as a "dividend" in the usual sense, or declared but not paid until later, or earned, but not distributed at any time until either by a partial or complete liquidation or dissolution. Thus equality of tax treatment is accorded to District residents as to *income* from corporate earnings. It seems to me the scheme of the statute in these several respects is completely clear.[9]

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[8] See note 3 *supra*.

[9] The Assessor had issued no regulations which spell out the term "dividend." I am confident my colleagues will not wish to be understood as saying that a "dividend" as they define it will result in taxability as though upon income if a stockholder takes a loss when a corporation upon liquidation returns *less* than his invested capital. The point is arguable, nevertheless. I read the majority opinion as intended to deal only with the distribution of amounts which "exceed the cost of the stock and represent corporate earnings." I have sought to make clear for my part that "surplus" may mean a great deal more than what has been earned by the corporation, and may include amounts which "exceed the cost of the stock." There must be hundreds of corporations in the District—not to mention corporations located elsewhere—whose

In sum, when the statute says that gross income shall not include capital gains resulting from the sale or exchange of capital assets as defined in the Code, it seems to me to assimilate that portion of the District law to the federal law with years of experience behind it. Thus shareholders in the District who wish to *speculate* must treat as ordinary income, gains on transactions in capital assets held for less than two years. But *investors*, who through a corporation help build asset value and whose holdings appreciate due to many valid causes, some, perhaps, wholly fortuitous, are bound upon liquidation of the corporate medium to pay a District income tax only upon such "surplus" as shall have been earned by the corporation. Whatever may be the tax liability of shareholders, such as these, to the federal Government, I think their District liability has expressly and purposefully been limited.

I would remand for a determination of whatever facts may measure District income tax liability according to the criteria I have suggested.[10]

stock is owned by District residents, the holdings of which are concentrated in real estate, or oil properties or mining ventures, for purposes of illustration, which vastly appreciated in value in recent years. That increment in value is *surplus*, largely unearned. See Edward v. Douglas, *supra*.

[10] See Commissioner v. Munter, 331 U. S. 210, 216, 217 (1947).

APPENDIX B

§ *47-1557. Net income.*

For the purposes of this article and wherever appearing herein, unless otherwise required by the context, the words "net income" mean the gross income of a taxpayer less the deductions allowed by this article. (July 16, 1947, 61 Stat. 335, ch. 258, Art. I, Title III, § 1.)

§ *47-1557a. Gross income and exclusions therefrom.*

(a) The words "gross income" include gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, including salaries, wages, and compensation paid by the United States to its officers and employees to the extent the same is not exempt under this article, or income derived from any trade or business or sales or dealings in property, whether real or personal, other than capital assets as defined in this article, growing out of the ownership, or sale of, or interest in, such property; also from rent, royalties, interest, dividends, securities, or transactions of any trade or business carried on for gain or profit, or gains or profits, and income derived from any source whatever.

(b) The words "gross income" shall not include the following:

* * * * * * * * * *

(11) *Capital gains.*—Gains from the sale or exchange of any capital asset as defined in this article. (July 16, 1947, 61 Stat. 335, Art. I, Title III, § 2; May 3, 1948, 62 Stat. 207, ch. 246, § 3; May 27, 1949, 63 Stat. 130, ch. 146, Title IV, §§ 403, 420.)

§ *47-1551c. General definitions.*

For the purposes of this article and wherever appearing herein, unless otherwise required by the context—

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(l) The words "capital assets" mean any property, whether real or personal, tangible or intangible, held by the taxpayer for more than two years (whether or not connected with his trade or business), but do not include stock in trade of the taxpayer or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the end of the taxable year, or property held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business.

(m) The word "dividend" means any distribution made by a corporation (domestic or foreign) to its stockholders or members, out of its earnings, profits, or surplus (other than paid-in surplus), whenever earned by the corporation and whether made in cash or any other property (other than stock of the same class in the corporation if the recipient of such stock dividend has neither received nor exercised an option to receive such dividend in cash or in property other than stock instead of stock) and whether distributed prior to, during, upon, or after liquidation or dissolution of the corporation: *Provided, however,* That in the case of any dividend which is distributed other than in cash or stock in the same class in the corporation and not exempted from tax under this article, the basis of tax to the recipient thereof shall be the market value of such property at the time of such distribution: . . . (July 16, 1947, 61 Stat. 332, Art. I, Title I, § 4; May 3, 1948, 62 Stat. 206, ch. 246, §1; May 27, 1949, 63 Stat. 129, ch. 146, Title IV, §§ 401, 402.)

§ *47-1595. Commissioners to prescribe and publish rules.*

The Commissioners shall prescribe and publish such rules and regulations, consistent with the provisions of this article, as may be necessary and proper for its enforcement and efficient administration. (July 16, 1947, 61 Stat. 359, ch. 258; Art. I, Title XVI, § 1.)